

Gray Davis, Governor

Maria Contreras-Sweet, Secretary, Business, Transportation, & Housing Agency

Paula Reddish Zinnemann, Real Estate Commissioner

Summer 2001

Untangling a Non-Licensed Broker's Web of Deceit



*"What a tangled web we weave,
when we first practice to deceive."*

Truer words were never spoken when the Department began to unweave the tangled web of deceit spun by one particular mortgage brokerage operation. Off shore accounts, mice type disclosures, confusing contracts and deceitful business practices were all part of the mix. And the hook which lured the victims began with misleading advertising.

Center stage of the scam was the nonlicensed owner of the brokerage company. The business was run through a series of "rent a brokers", whose licenses, one by one, were revoked by the Department. For nearly a decade the Department had attempted to get the Defendant and associated licensees to comply with the Real Estate Law. The Department's efforts included the filing of Desist and Refrain Orders against the Defendant and his associates as well as filing Accusations against associated brokers and salespersons. Despite Desist and Refrain Orders and the license revocations of

associated real estate brokers, the Defendant continued his fraudulent business practices unabated.

When it became clear administrative efforts were not correcting the abhorrent practices, the case was referred to the Sacramento County District Attorney. The DA investigated more than two years before going to trial. The vigorous prosecution in this hard fought case was handled by a Sacramento County Deputy District Attorney and a Department of Real Estate Legal Counsel, appointed as a Special Deputy District Attorney. Litigation support was provided by a Deputy Real Estate Commissioner from the Department's Enforcement Section.

Concluding two months of trial, a Sacramento County Superior Court Judge announced an intended decision supporting a permanent injunction in a civil case against the Sacramento based corporation and its president for fraudulent business practices in connection with the Defendant's mortgage loan brokerage and loan servicing activities.

The Judge concluded that the Defendant's fraud was perpetrated by a continuous and regular practice of misleading statements in contravention of Business and Professions Code Sections 17200 and 17500.

The following excerpts from the Judge's Intended Decision describe in some detail the egregious conduct of the Defendant:

"At the heart of the scheme was a flyer prepared by the defendant and sent to some 230,000 homes over the period in question. In it an interest rate for home refinancing was advertised at what was called the current effective rate or the equivalent rate. This was the quintessential "hook" not dissimilar to those used in a variety of frauds.

By this quoted rate of interest was really meant the net interest rate assuming a biweekly payment of principal and interest instead of the usual monthly payment. For example, at an actual note rate of 8% say, if payments are made biweekly then

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Late Period Allows Renewal of Expired Licenses *but renewing on time is the way to go!*

A real estate licensee has the ability to renew his or her license during the two year period after the license has expired. It is critical to note that after the license has expired, and during the aforementioned two year period, no license activity is permitted until a renewed license has been issued.

Therefore, it is advisable to apply for renewal **prior** to the license expiration. As per Section 10156.2 of the Business and Professions Code, a licensee who files his/her renewal on time and satisfies the requirements for renewal, including good

faith evidence of compliance with the continuing education requirements, can continue to operate under the existing license while they await their license renewal certificate. Normal processing of renewals takes approximately two to three weeks, but problems with renewal applications or continuing education courses can significantly delay processing. The renewal license certificate is usually processed and issued near the license expiration date. Section 10156.2 also provides that if a licensee submits an appropriate application, fee and good faith evidence of completion of the

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MORTGAGE LOAN BULLETIN

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STATE OF CALIFORNIA
GRAY DAVIS, *Governor*

BUSINESS, TRANSPORTATION AND
HOUSING AGENCY
MARIA CONTRERAS-SWEET
Secretary

DEPARTMENT OF REAL ESTATE
PAULA REDDISH ZINNE MANN
Real Estate Commissioner

Principal Office

2201 Broadway
Sacramento, CA 95818

Mailing Address

P.O. Box 187000, Sacramento, CA
95818-7000

Telephone

(916) 227-0770

John R. Liberator
Chief Deputy Commissioner

Robin Wilson
Chief Counsel

Randy Brendaia
*Managing Deputy Commissioner IV
Mortgage Lending*

Gary H. Sibner
*Senior Deputy Commissioner
Mortgage Lending Advertising*

Mark Tutera
*Senior Deputy Commissioner
Mortgage Lending*

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DRE's Internet address is:
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From Secretary Maria Contreras-Sweet:

Over the next decade California is expected to lead the nation in job, population and income growth. The Business, Transportation and Housing Agency is preparing today for the growth that will challenge all our infrastructure systems.

For the past two years, Lt. Governor Cruz Bustamante and I have co-chaired a commission charged by the Governor with developing an infrastructure investment strategy for California's future. The work of the 48-member Commission on Building for the 21st Century recently wrapped up and we'll be presenting a final report to the Governor later this summer. Our Agency will then conduct an aggressive educational effort to inform Californians on the state's infrastructure needs.

As the State Secretary for transportation, I can tell you that we are approaching California's transportation needs on many fronts: through highways, passenger rail, mass transit, improved land use planning and a concern for the environment we all share.

More than \$6.8 billion has been appropriated to relieve traffic congestion, improve goods movement and maintain local transportation systems. Of that total amount, \$5.3 billion is for the Governor's Traffic Congestion Relief Program to cut congestion and facilitate growth. The CHP, DMV, Caltrans and the Office of Traffic Safety are working in a cross-cutting manner within our Agency to assist me in meeting the Administration's transportation objectives.

As the State Secretary for housing, my goal is to ensure that our economic prosperity is not derailed by a lack of housing for California's workforce. More than \$400 million has been added to the state's budget for housing. This augmentation – the first for housing in more than a decade – is being put to use by me with assistance from the Department of Housing and Community Development, Department of Real Estate, and the California Housing Finance Agency.

Most of California's anticipated growth in housing is expected to take place in metropolitan areas where businesses share space with city neighborhoods. The Governor's new Downtown Rebound program encourages creative and innovative use of land in these areas, such as adapting non-residential buildings into safe housing mixed with commercial uses. As the State Secretary for business regulation, I take pride in protecting the people who live in these communities. We are protecting them through the business regulation efforts of our departments – the Department of Alcoholic Beverage Control, Department of Corporations, Department of Financial Institutions, Department of Managed Health Care, Department of Real Estate, the Office of the Patient Advocate, and the Office of Real Estate Appraisers.

The 47,000-plus employees of the Business, Transportation and Housing Agency are to be commended for helping us take the steps that will improve the daily lives of all Californians. Through our efforts, traffic on freeways will move faster, water and energy will be more plentiful, schools will be better, and more residents will be able to afford a home. That's what I call a Golden State. 🌞



Thank you for conserving energy!

Your conservation efforts have helped California make great strides toward resolving our energy challenge.

Continuing to "flex your power" will help avoid blackouts, ensure public safety, and prevent harm to the state economy. Here are some ideas:

For Businesses

- ⚡ Set thermostats to 78 degrees or above this summer.
- ⚡ Engage your employees in conservation efforts and encourage them to be energy conscious.
- ⚡ Buy energy-efficient equipment. When purchasing computers, monitors, printers, fax machines and copiers, choose ENERGY STAR® models that "power down" when idle.

For Individuals

- ⚡ Turn off lights and appliances that are not essential.
- ⚡ Set your thermostat to 78 degrees or higher during warm weather and to 68 degrees or lower during cold weather.
- ⚡ When shopping for lights and appliances, choose efficient ENERGY STAR® products.
- ⚡ Delay the use of clothes dryers and other large appliances until after 7 pm.

For Everyone!

Have you heard about the Save Energy Pledge?

Hundreds of businesses, organizations, and individuals throughout the state have made a commitment to save energy and help spread the word about the importance of conservation.

You can join them! Go to www.flexyourpower.ca.gov or visit any DRE office to take the pledge.

Check out www.flexyourpower.ca.gov for more ways to save!

Rebates and Incentives Make Cents



The Consumer Energy Center's Rebate and Demand Reduction Database lists energy rebates and incentive programs available for everything from air conditioners to roofs, including energy-efficient mortgages. Go to www.flexyourpower.ca.gov and click on "financial incentives".

The 20/20 Energy Rebate Program offers customers of participating utilities a 20% rebate on their summer electricity bill if they cut back their electricity use by 20% over last summer's level. For more information contact:

Pacific Gas and Electric Company

1-800-933-9555 (residential customers)

1-800-468-4743 (business customers)

www.pge.com/003_save_energy/003a_res/2020/

San Diego Gas and Electric Company

1-800-411-7343

www.sdge.com/efficiency/index.html

Southern California Edison

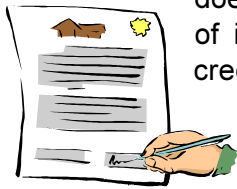
1-800-736-4777

www.sce.com/002_save_energy

Table or Concurrent Funding - Prohibited or Not?

(reprinted from Mortgage Matters article)

The issue of table, or concurrent, funding is one that still prompts many telephone calls to the DRE asking if it is permitted. A typical table funding transaction will occur when a broker, in negotiating a loan between a prospective borrower and a lender on a 1 to 4 unit residential property, places its own name in the promissory note and deed of trust as beneficiary (lender) but does not actually fund the loan out of its own funds or independent credit line. The broker merely records the deed of trust containing its name and then records an assignment of the deed of trust into the name of the lender actually funding the loan. Concurrent funding will occur when the broker funds the loan, places its name as the lender in the promissory note and deed of trust and concurrently records both the deed of trust and assignment of the deed of trust to the pre-arranged lender.




Assembly Bill 1203 (Leach) effective January 1, 1999, amended Business and Professions Code (BPC) §10234 to allow a broker to record the deed of trust in its own name in certain transactions. BPC §10234 now reads as follows:

- (a) Except as provided in subdivision (d), every real estate licensee who negotiates a loan secured by a trust deed on real property shall cause the trust deed to be recorded, naming as beneficiary the lender or his or her nominee (who shall not be the licensee or the licensee's nominee), with the county recorder of the county in which the real property is located prior to the time that any funds are disbursed, except when the lender has given written authorization for prior release.
- (b) If funds are released on the lender's written authorization as described in subdivision (a), the trust deed shall be recorded, or delivered to the lender or beneficiary with a written recommendation that it be recorded forthwith, within 10 days following release.

- (c) Every real estate licensee who sells, exchanges, or negotiates the sale or exchange of a real property sales contract or a promissory note secured by a trust deed on real property shall cause a proper assignment of the real property sales contract or trust deed to be executed and shall cause the assignment to be recorded, naming as assignee the purchaser or his or her nominee (who shall not be the licensee or the licensee's nominee), with the county recorder of the county in which the real property is located within 10 working days after the licensee or seller receives any funds from the buyer or after close of escrow; or shall deliver the real property sales contract or trust deed to the purchaser with a written recommendation that the assignment thereof be recorded forthwith.

- (d) A trust deed may be recorded in the name of the real estate broker negotiating the loan if all of the following apply: (1) the lender or purchaser is any person or entity set forth in paragraph (1) of subdivision (c) of Section 10232, (2) the trust deed is recorded with the county recorder of the county in which the real property is located, and (3) the real property securing the loan as described in the trust deed is not a dwelling as defined in Section 10240.2 or unimproved real property.

As a practical matter, this allows a broker to engage in the practice of "table" or "concurrent" funding only when the property securing the loan is a dwelling with 5 or more units, or a commercial property, and the loan is made by an institutional investor. Any practice in which a licensee, who is not the lender, negotiates a 1 to 4 unit residential real estate loan and records the deed of trust in its own name is a violation of BPC §10234. It should be noted that compliance with this requirement is part of the DRE's audit program and violations could subject the broker to possible disciplinary action. 



Department of Real Estate Offices will remain open during temporary power interruptions

Due to the current statewide energy situation, it is possible that temporary power interruptions may occur in areas where Department of Real Estate (DRE) offices are located. In the event a temporary blackout should occur, the DRE has established procedures for all of its offices to remain open.

The DRE expects that its telephone systems should continue to function during a power outage, which will allow normal consumer and licensee inquiries to be handled. License, examination and subdivision applications, and other paper transactions will be accepted, receipted and subsequently processed once power is restored. However, the computer system may not be operational and as such, staff will not be able to access DRE license record information during a blackout period.

The Department will continue to assess its ability to function during power interruptions in order to minimize any inconvenience to the public. Your understanding is appreciated. 🧐

Overcharging of Fees May Result In Disciplinary Action

Typically in a mortgage loan transaction, the broker will ask the prospective borrower to pay, in advance to the broker, fees for obtaining the credit report(s) and/or property appraisal. The Department has taken the long standing position that the up-front collection of these two fees by the broker will not be treated as advance fees and therefore not subject to the submission of an advance fee contract and materials for the Department's review pursuant to Business and Professions Code (BPC) §10085. A good faith estimate of these fees must be given by the broker to the prospective borrower via disclosure statement as required by BPC §10240, and the broker must collect as near as possible the exact amount of the fees. The funds must also be deposited into the broker's trust account for subsequent dispersal to the vendor(s) and maintain proper records pursuant to BPC §10145 and regulations 2831 and 2831.1.

If, however, a broker over-collects on either of these fees, a direct refund must be made to the

borrower of the excess over the actual cost of the services, or an adjustment must be made at closing. Failure to do so may subject the broker to disciplinary action by the Department for several reasons. First, the excess fees collected and not reimbursed will constitute an advance fee as defined in BPC §10026 triggering the requirement to submit a proposed advance fee contract and materials to the Department for review. Second, BPC §10176(g) prohibits a broker from taking any secret or undisclosed compensation, commission or profit. The overcharging of appraisal and/or credit report fees by a broker, even unintentionally, could subject the broker to the expense of defending himself or herself in an administrative proceeding as well as the possible suspension or revocation of the license.

Clearly it is incumbent on brokers to have in place a procedure to determine the actual third party cost of these services and for the proper adjustment or refund of excess charges to their customers. 🧐



Web of Deceit

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the loan will pay off earlier with a consequent interest savings which can be recalculated to 6%, or the like. The loan is still 8% however; it is simply paid off earlier. This reduction is available on all loans with no pre-payment penalty, a commonplace in the real estate loan market of the 90s.

Consumers, however, were lured into defendant's business based upon a false and misleading statement that led both the wary and

unwary to believe that they could secure loans

at very competitive rates when the opposite was true. Indeed, many customers ended up financing with new loans bearing even a higher note rate than their existing loan.

As the Court previously ruled in *limine*, the flyer was in violation of Regulation Z and defendant enjoyed no exemption from its application. That this federal rule was violated is no bar to proceedings under California's consumer protection and unfair business practice statutory scheme. Rather, it is evidence of misleading statements within the meaning of state law.

By reason of this violation of law alone, the People have met their burden. However, the evidence established that the conduct of defendant involved even more sinister misdeeds.

Firstly, while the ordinary consumer would expect that biweekly payments would be made to the lender when automatically deducted from the customer's bank account, such was not the case. In the fine print (indeed unreadable print) defendant retained the right to keep all payments over the monthly payment called for in the note (the 13th payment) at his sole discretion. Defendant refers to this as a "demand obligation" based on funds received by him from the customer in an arm's length transaction. He argues that such funds are not subject to any trust requirements. The court is satisfied that the evidence belies any understanding on the part of consumers that they were entering into such a transaction which is essentially an investment of their money with the defendant with no

expectation of any return.

....

Secondly, and even more egregious, defendant offered what was called a line of credit to his customers, called suggestively the "Ready Reserve Account." They were advised that money could be made available to them and subject to repayment only when drawn upon. In fact, the amount of such credit line was fully funded at close of escrow and all the proceeds

Consumers were lured into the web by a false and misleading statement...

may have been actually requested by the borrower. This, too, defendant claims to be a "demand obligation" fairly arrived at between him and his customers. The truth is otherwise. Here, as with the 13th payment money, defendant gained the use of his customers' money which he treated as his own without any investment benefit to the customer. Defendant adverts to the fact that by this so-called Ready Reserve account the customers secured for themselves a loan, the proceeds of which they could access upon demand to defendant. This claim overlooks the fact that in fact it was defendant who secured the loan proceeds, subject only to some future demand upon the part of consumers. Doubtless some might never make such a demand since they were unaware of having borrowed the money in the first place. Indeed borrowers were assured in many instances that they were not responsible for any of the Ready Reserve money unless advanced. The contrary, of course, is the trust vis a vis the lenders.

....

Supporting the determination that defendant's business was essentially a fraud a substantial amount of evidence was adduced with response to a variety of subterfuges relating to many of the loans at issue.

Defendant encouraged the practice of having only his loan officers present at escrow closings instead of title officers who commonly conduct such meetings. It is evident that this procedure was uti-

paid to defendant except such sums as

Where is the money?

lized to cloud the true state of affairs, which was reflected in the escrow documents. For example, some consumers claimed that they had agreed only to a single note and deed of trust. In actuality, they entered into a first and second mortgage in order to secure the amounts needed to obtain the desired funding or reserve amount. These were never referred to as first and second deeds of trust, but only as a "two step" process. Indeed some required multiple closings which were explained as necessary merely to correct some errors.

Customers were told to disregard the Truth and Lending statements which the lender would send them, and to toss the coupons they would likely receive. Many relied on this advice in reliance upon the representations made to them by defendant's loan officers. All of this was to delay as long as possible the realization that the note rate was higher than advertised and that they had encumbered their homes by amounts in excess of what they had borrowed.

....

Where is the money? This twisted tale is further evidence of the fraudulent scheme in which the defendant has engaged in for so long. He is loath to explain where the money is and in several instances denied any responsibility for it. It seems

to have wended its way to a Cayman Islands company operating in Nevada which in turn

lent it to various entities controlled by Defendant and then in turn invested in various real estate transactions resulting in trusts for his own children or annuities on his own life with his wife as beneficiary. In all, the matter was so convoluted that the defendant was himself hard-pressed to delineate with any particularity just where the money is and who is responsible for it. Also, but for defendant's own estimate of some 1.5 million dollars, we do not have sufficient evidence of just how much money has gone missing or what is owed and to whom. There remains the frightening possibility that many more consumers have paid money over to defendant than have been discovered to date. Substan-

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Web of Deceit

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tial difficulty will be presented in fashioning a remedy sufficient to protect such persons from loss as well as those whose identities are known.

....

The court will make permanent the preliminary injunction previously made in this case. It will also seek to fashion an order by which the persons who were duped into dealing with defendant are given the opportunity to be made whole. The court also declares as a resulting or constructive trust all monies collected by defendant from participants in his bi-weekly or ready reserve accounts. These monies were at all times subject to the requirement of trust regulations of the Department of Real Estate and are deemed now to be in trust."

Most recently, the judge issued his Judgement After Trial By Court which orders, in part,

- Plaintiff, the People of the State of California shall have judgement against defendants.... (collectively "Judgement Debtors"), as and for civil penalties in the amount of One Million Two Hundred Fifty Thousand Dollars (\$1,250,000).

- A Receiver shall be appointed pursuant to the provisions of California Business and Professions Code section 17535, California Code of Civil Procedure sections 564 (b)(3), and 564 (b)(8), and California Code of Civil Procedure section 708.620, to accomplish restitution on behalf of members of the public who have sustained damages as a result of the acts and omissions of Judgement Debtors.

- The Judgement Debtors shall cooperate with the Receiver and immediately respond to any and all requests made by the Receiver.

The order also makes permanent the aforementioned preliminary injunction.

Although the Judgement is subject to appeal, these initial positive results would not have been possible without the cooperation between many regulatory agencies and the hard work of many dedicated people. Because of such efforts, the bad actors can be weeded from the industry which benefits both the consumers and honest practitioners. 🧐

Revised Multi-Lender Transaction Notice (RE 860)

Business and Professions Code §10229(a) requires brokers who arrange or sell fractionalized (multi-lender) interests in real property loans to private investors to file with the DRE an original or amended Multi-lender Transaction Notice (RE 860). The Notice must be filed within 30 days of the broker's first transaction or within 30 days of any material change to the information contained in the Notice.

Assembly Bill 2284 (Dutra), effective January 1, 2001, revised the form to expand the information contained in the Notice. Brokers who are required to submit the Notice must now use the revised form which can be downloaded from our website at www.dre.ca.gov. Please contact the Mortgage Loan Activities Section at (916) 227-0770 with any questions regarding the completion and/or filing of the Notice. 🧐

Renewal of Expired Licenses

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continuing education requirement the applicant may continue to operate under the existing license after its expiration date. Thus, even though an applicant renews on time just prior to the expiration date and does not have possession of a renewal certificate for approximately two to three weeks after the expiration of the current license, the law provides that the applicant can continue to perform licensed acts.

However, if you use the late renewal provision to apply for renewal **after** your license expires, you must wait until you receive your license renewal certificate to perform activities which require a license. Otherwise, you risk disciplinary action by the Department.

To renew an expired license during the late renewal period, submit:

- a proper renewal application;
- proof of legal presence (only if not previously submitted);
- late renewal fee; and
- evidence that required continuing education courses have been **completed within four years of the renewal application.**

The late renewal period for late renewals is not available to a new salesperson whose initial conditional license has been suspended for failure to meet statutory educational course requirements. Unless the suspension is lifted prior to the end of the initial four-year license term, the salesperson must re-qualify for licensure through the examination process.

Unfortunately, some individuals forget to renew their licenses within the two-year late renewal period immediately following their license expiration date. These licensees have to re-qualify for licensure through the examination process and meet the educational and experience requirements in effect at the time of examination application.

The bottom line is: **Be careful not to let your license expire!** 🧐

Summer 2001 — Mortgage Loan Bulletin



**Real Estate Commissioner
Paula Reddish Zinnemann
has pledged to save energy.
YOU CAN TOO!**

California is facing an energy challenge this summer, but we can save money and avoid outages by conserving energy whenever possible. Please join us in making a commitment to reduce the use of electricity by 20 percent or more this summer and urge others to do the same.



Take the **Save Energy Pledge** at
www.flexyourpower.ca.gov or any DRE office.